OECD guidance on transfer pricing implications of Covid-19 2/3/21

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The unique economic conditions arising from Covid-19 and national restrictions have caused certain difficulties in applying the arm's length principle for transfer pricing analysis. To pick up where we left off in our article Covid-19: transfer pricing impact, this one explores Guidance on the transfer pricing implications of Covid-19 the OECD published in late 2020.

Topics covered by the Guidance

The Guidance emphasises that transfer pricing analysis should continue to rely on the OECD's Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations dated July 2017 even in the unique circumstances caused by Covid-19. The Guidance focuses on how the arm's length principle and the Guidelines relate to issues that can arise or become aggravated in the context of Covid-19, rather than on drawing up any specialised guidance to go beyond the instructions and recommendations currently made in the Guidelines.

To mitigate the effects of Covid-19 on transfer pricing analysis, the Guidance looks at four key matters dealt with in separate chapters:

- Comparability analysis;
- Losses and the allocation of Covid-19 specific costs;
- Government aid programmes;
- Advance pricing agreements.

The Guidance emphasises that although the matters are explained as four separate topics, they can be mutually related and should therefore be considered together with the interpretations offered in the Guidelines.

Comparability analysis

Unprecedented changes to the economic environment following the outbreak of Covid-19 have created unique difficulties in performing a comparability analysis. The Guidance states that the pandemic can affect pricing between related and unrelated parties, as well as reducing the scope for relying on historical data. The Guidance looks at comparability analysis in a series of questions, the most important being set out below.

1. *What sources of information can be used to prepare a comparability analysis for controlled transactions in 2020?*

The Guidance says that any sort of publicly available information on how Covid-19 affects business, industry and controlled transactions deserves to be analysed with a company's transfer pricing policy for 2020. The Guidance lists several sources of information that can be used in transfer pricing analysis, such as information on sales volumes, macroeconomic trends, additional or extraordinary costs, budgeted data against actual data etc.

1. *Can budgeted data be used as a basis for charging an arm's length price?*

The Guidance states that financial results a taxpayer would have achieved in a controlled transaction but did not because of Covid-19 provide useful information for determining how Covid-19 affects the financial results and transfer prices. It is important to note that when it comes to comparing budgeted data with actual data, we need to consider all economic factors affecting the financial results in order to measure the isolated effect of the pandemic.

1. *What practical approaches can be taken to deal with the lack of information?*

The Guidance urges tax authorities to consider taking pragmatic approaches in dealing with the lack of reliable comparables in order to minimise disputes where taxpayers try to identify arm's length prices in good faith, for example:

- Allowing the use of a reasonable commercial assessment with updated information to determine an arm's length price;
- Allowing the *ex-post* approach (checking the actual results) with adjustments to tax returns based on information that became available when the tax year ended, instead of the *ex-ante* approach (checking prices before the transaction);
- Allowing the use of more than one transfer pricing method to confirm an arm's length price.

1. *Can data from other crises be used for transfer pricing purposes?*

According to the Guidance a comparability analysis that is based only on information from the 2008–2009 global financial crisis would create significant comparability risks, given the unique and unprecedented nature of Covid-19. When it comes to selecting years suitable for a comparability analysis, we need to ensure that financials for years affected by the pandemic do not unduly distort the results of pre-pandemic or post-pandemic periods.

1. *What steps can we take to evaluate our set of comparable companies or transactions?*

When preparing a comparability analysis and selecting companies with financial results for 2020, the taxpayer might have to revise the criteria applied in the benchmarking study. For example, the impact of national restrictions can cause significant differences between the profit indicators of companies operating in the same sector. When it comes to reflecting the impact of Covid-19 and related restrictions, it might be necessary to revise and relax other comparability criteria in order to obtain credible data from the most comparable market (country).

1. *Can we select companies with losses in our comparability analysis?*

In a benchmarking study, we should not be rejecting companies only because they reported losses in periods affected by Covid-19. If the benchmarking study finds that a company performs comparable functions and takes comparable risks there is no reason to exclude it from our selection.

We will be posting more on the remaining topics of Guidance on the transfer pricing implications of Covid-19.